



REGULATORY GUIDANCE
On Property and Casualty Statutory Statements of Actuarial Opinion
For the Year 2010

Prepared by the NAIC's
Casualty Actuarial and Statistical (C) Task Force

Introduction

The Casualty Actuarial and Statistical (C) Task Force (CASTF) of the NAIC believes that the Statement of Actuarial Opinion (Opinion) is a valuable tool in serving the regulatory mission of protecting consumers. This Regulatory Guidance document supplements the NAIC's *Property and Casualty Annual Statement Instructions (Instructions)* in an effort to provide clarity and timely guidance to companies and Appointed Actuaries regarding regulatory expectations with respect to the Opinion.

An Appointed Actuary has a responsibility to know and understand both the *Instructions* and the expectations of regulators. One expectation of regulators clearly presented in the *Instructions* is that the Opinion and the supporting report and work papers should be consistent with appropriate Actuarial Standards of Practice (ASOP), including *but not limited to* ASOPs Nos. 9, 23, 36 and 43. While the Actuarial Standards Board may have been considering a repeal of ASOP No. 9, that action has been deferred. Many regulators oppose this repeal, viewing it as a clear reduction in the standards expected in an actuarial work product. Regardless of any action by the Actuarial Standards Board, regulators expect that all Opinions and the supporting Actuarial Reports continue to meet the standard of ASOP No. 9.

The CASTF consciously avoids illustrative language in the *Instructions* and encourages all actuaries to use whatever language they feel is appropriate to clearly convey their opinion *and* thought processes in reaching conclusions on a company with reference to specific characteristics of that company in both the Opinion and the supporting report.

Paragraph 1: Appointment, Definitions, Exemptions, and Special Requirements for Pooled Companies

Paragraph 1 is directed to company management and changed slightly in 2009 to clarify the interests of regulators when an initial actuarial appointment or change in Appointed Actuary is made. The CASTF expects that an actuary considering a new assignment is aware of the requirement and will request similar information from the company and the former Appointed Actuary in order to make an informed decision about accepting the assignment.

Both company management and a potential Appointed Actuary should be mindful of the following:

- **Timely feedback** — The CASTF encourages management to seek feedback from a “qualified actuary” *prior to* management’s decision on establishing carried reserves. This allows management to make an informed decision with the benefit of actuarial analysis. It also helps to avoid a difficult situation in which management is committed to a decision that results in pressure on the actuary to “stretch” the range of reasonable reserve estimates.
- **Reporting to the Board or Audit Committee** — The actuary is required to report to the Board. This may be done in a form of the actuary’s choosing. The CASTF strongly encourages the Appointed Actuary to present his or her analysis in person so that the risks and uncertainties that underlie the exposures and the significance of the actuary’s findings can be adequately conveyed and discussed. As the actuarial profession makes advances in reserve methodology, such as stochastic simulation, a single deterministic indication would not be appropriate for many companies. While management is limited to single values on lines 1 and 3 of the Liability Page, the Board should be made aware of the actuary’s opinion regarding the risk of material adverse deviation, the sources of that risk, and what amount of adverse deviation the actuary judges to be material.

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Paragraphs 1A, 1B and 1C are unchanged for year-end 2010, but we include the following for your consideration.

Paragraph 1C: Special Requirements for Pooled Companies

Paragraph 1C applies only to those situations where there is an intercompany pooling agreement in which the lead company retains 100% of the pooled reserves and the other members of the pool retain 0%. In this situation, the Schedule P of the 0% companies is blank, and rendering an Opinion on non-existent values is virtually useless to the regulator. For these situations only, the actuary is directed to prepare an Opinion on the Pool, which is to be filed with the Annual Statement of each of the pooled companies.

Exhibits A and B should reflect values specific to the individual company. Additionally, the actuary should prepare Exhibits A and B of the Pool to be filed as an addendum to the Opinions of the 0% companies. This will allow for proper data submission for each company in the Pool while accommodating the greatest distribution of the relevant values for the Pool. The *Instructions* include specific answers for the Exhibit B questions regarding materiality and the risk of material adverse deviation. Note the distinction between pooling with a 100% lead company with no retrocession and ceding 100% via a quota share agreement. These affiliate agreements must be approved by the regulator as either an intercompany pooling arrangement or a quota-share reinsurance agreement. The proper financial reporting is dependent on the approved filings, regardless of how company management regards their operating platform.

Paragraph 2: Structure of the Opinion

Paragraph 2 is unchanged for 2010. It succinctly presents the four primary sections of the Opinion.

Paragraph 3: Identification

Paragraph 3 is unchanged for 2010.

Paragraph 4: Scope

Paragraph 4 is unchanged for 2010. Editorial changes relate to items in the exhibits. Exhibit A provides a clear picture of what items are to be opined on by the actuary. Guidance for Exhibit B disclosure items is discussed in Paragraph 6.

The CASTF calls attention to two continuing items of interest to regulators that pertain to the Scope of the Opinion:

1. **Exposure** — An Opinion on the reasonability of the carried reserves should reflect consideration and evaluation of more than just loss history. ASOP No. 36 §3.5.2 calls for the actuary to give attention to “exposures that are new or unusual and that are likely to be insufficiently reflected in the experience data or in the assumptions used to estimate loss and loss adjustment expense reserves.” The CAS Statement of Principles on Loss and Loss Adjustment Expense Reserves and other actuarial literature address the relevance of exposure to the reserve actuary’s work. The CASTF expects the actuary to probe and understand the exposure associated with the company for which the Opinion is issued. Areas of particular interest to regulators include:
 - Coverage for Service Contracts: Due to wide variation in state laws, this type of product may or may not be regulated or treated as insurance. Insurance may only come into play as excess coverage for contractual liability. The insurer and the Appointed Actuary often have no underlying data on loss experience absorbed by the policyholder. When losses break through the retention, they can be catastrophic for the insurer, particularly a specialty writer or a risk retention group with concentration in this exposure.
 - D&O and XS Coverages: For any coverage with extended emergence patterns, regulators expect that the actuary’s analysis will demonstrate attention to factors that influence the underlying exposure and potential for claims subject to the coverage provided.
 - Economic Conditions: A number of Opinions identify various economic conditions as risk factors. With the current strains on the economy—and housing markets in particular—regulators expect the Appointed Actuary of a company that faces such risks to attempt to quantify those risks in the analysis. Regulators find that mere disclaimers are insufficient. Actuaries should consider the potential for premium deficiencies, particularly in long-duration contracts such as mortgage and/or financial guaranty products. The actuary may include the Premium Deficiency Reserve in Exhibit A and comment accordingly within the Opinion. The CASTF advises actuaries to contact the regulator of domicile for further guidance on expected disclosure.

The understanding can be disclosed in the Opinion with Relevant Comment regarding what the actuary believes to be the financial condition of the obligor(s) for service contracts, the coverages subject to increased activity within the policyholder's retention, and the emerging risk factors. These are examples of what regulators expect the actuary to address as "specific characteristics of the company."

2. **Prepaid loss adjustment expenses** — According to Interpretation 02-21 in Appendix B of the NAIC's *Accounting Practices and Procedures Manual*, the liability for unpaid loss adjustment expenses should be established regardless of any payments made to third-party administrators (TPA), management companies, or other entities. The values should be recorded as loss adjustment expense reserves throughout the Annual Statement and not recorded as a write-in. Appointed Actuaries should be aware of any such arrangements, incorporate this consideration into their analysis, and include appropriate disclosures in the Opinion and the Actuarial Report.

The Scope paragraph also requires disclosure of the individual upon whom the Appointed Actuary relied for preparation of the data. In some cases, the Appointed Actuary, if a senior officer of the company, may be the individual who holds this responsibility. In these cases, it is acceptable for the actuary to identify himself/herself in this section.

The CASTF recognizes that the Appointed Actuary may receive data from a TPA, accounting firm or similar organization that provides service to the regulated entity. If such a relationship exists, it is informative to identify it in this section. However, any third party or firm is not the regulated entity.

Regulators expect the Appointed Actuary's disclosure to always include the senior official(s) of the regulated entity responsible for integrity of the data.

Paragraph 5: Opinion

Paragraph 5 is unchanged for 2010. The CASTF expects points C and D of the Opinion paragraph to be the full and complete expression of the Appointed Actuary's conclusion on the type of opinion rendered. Regulators will presume that the conclusion will apply to both the net and the direct and assumed reserves. If the actuary reaches different conclusions, the actuary should use whatever language is appropriate to clearly convey a complete opinion. If faced with this situation, the actuary should prepare exhibit entries to reflect the opinion on the Net reserves. The CASTF encourages the actuary to include narrative comments to describe any differences with respect to the Direct and Assumed opinion.

Paragraph 6: Relevant Comments

Paragraph 6 is unchanged for 2010. The CASTF considers the relevant comments of the Appointed Actuary to be the most valuable information in the Opinion. Relevant comments provide the context for the regulator to interpret the Opinion and to understand the actuary's reasoning and judgment.

Risk of Material Adverse Deviation (RMAD)

The *Instructions* require the Appointed Actuary to:

- 1) Identify the materiality standard.
- 2) Identify the basis, or rationale, for establishing this standard.
- 3) **Explicitly** state whether he or she believes that there are significant risks and uncertainties that could result in MAD.
- 4) If such risk exists, the actuary should describe the major factors or particular conditions underlying the risks and uncertainties that the actuary reasonably believes could result in MAD. (Note that the actuary is encouraged to comment on the risks and other factors considered even when no RMAD is judged to exist.)

The actuary's comments regarding RMAD should be consistent with the disclosure in Exhibit B, item 6. If the actuary concludes that RMAD is present, the CASTF expects the supporting Actuarial Report to clearly address each of the risk factors identified with descriptive and quantitative information on alternate outcomes that would drive adverse development beyond the selected materiality threshold. This information will be useful to both regulators and the Board in understanding the actuary's comments on this issue.

The Appointed Actuary is reminded that each statutory entity, except for those following paragraph 1C of the *Instructions*, is required to have a separate Opinion and, therefore, its own materiality standard. Where there are no unusual circumstances to consider, it may be acceptable to determine a standard for the entire pool and assign each member their proportionate share of the total. It is **not** appropriate to use the entire amount of the materiality threshold for the pool as the standard for each individual pool member. For those companies following paragraph 1C of the *Instructions*, the non-lead companies' materiality standard should be \$0.

The *Instructions* state that the RMAD explanatory paragraph should not include general broad statements about unspecified risks and uncertainties that could apply to nearly all companies in any situation. When considering the inclusion of risk disclosures in the Opinion, the actuary should take into account the likelihood of the event occurring. Risks and uncertainties may include items such as the uncertainty in the tail factors or the need to use industry benchmarks. *Specified* contemporary risks—such as subprime mortgage exposure or declining real estate values—may be relevant to the extent that they can be significant and directly related to adverse deviation.

When concluding whether RMAD exists, the Appointed Actuary is advised to consider the materiality standard in conjunction with the range and the carried reserves. For example, if the materiality standard when added to the carried reserves exceeds the high end of the range, it may be logical to conclude that RMAD does not exist. Likewise, if the materiality standard when added to the carried reserves is within the high end of the range, RMAD likely exists. In either case, the actuary should support the conclusion.

IRIS Ratios

The CASTF considers it insufficient to attribute an unusual reserve development ratio to reserve strengthening alone and expects relevant comment on an unusual ratio to provide reasonable insight as to the company-specific factors that caused the result. Detailed documentation should be included in the Actuarial Report to support comments in the Opinion.

Paragraph 7: The Actuarial Report

Paragraph 7 is unchanged for 2010. The CASTF believes that the *Instructions* and ASOP No. 9 provide the best guidance to actuaries regarding the Actuarial Report and supporting documentation.

Exhibits alone rarely convey professional conclusions and recommendations or the significance of the actuary's opinion or findings. A narrative section should provide clearly worded information so that readers are able to appreciate the significance of the actuary's findings and conclusions, the uncertainty in the estimates, and any differences between the actuary's estimates and the carried reserves. Sources of assumptions should be clearly supported. The CASTF has identified three notable weaknesses in the documentation of many actuarial reports.

1. **Expected Loss Ratios.** Methodologies that rely on an expected loss ratio may well be the most suitable in a given situation. When using these methodologies, particularly in a long-tailed line with high premium volume, the CASTF expects the documentation to include recognition of pricing and underwriting information in the recent years, loss costs, and loss inflation. Historical loss ratio indications have little value if rate actions, credit adjustments or program revisions have affected premium adequacy or inadequacy.
2. **Actuarial Judgment.** The use of this phrase in a Report, in either the narrative comments or in exhibits, is not considered to be proper explanation without sufficient descriptive rationale to provide meaningful context for this term.
3. **Schedule P Reconciliation.** The CASTF believes that a summary reconciliation (all years and all lines combined) is an insufficient demonstration of data integrity. A reconciliation should include enough detail to reflect the line of business structure used in the reserve analysis, the accident years of loss activity, and the methods used by the actuary. When premiums are relied upon in the analysis, premiums should be a part of the reconciliation.

The CASTF recognizes that company line of business definitions may be more meaningful than Annual Statement line of business definitions. Such differences in data classification should be addressed and clearly documented within the Report. The required reconciliation should illustrate differences between the data used in the actuary's analysis and the amounts

presented in Schedule P of the Annual Statement. The actuary should address the reasons for any significant differences in order to reduce questions regarding data integrity.

In addition, the CASTF supports the recommendation of the Casualty Actuarial Society's Task Force on Actuarial Credibility that the Actuarial Report contain an exhibit that summarizes changes in the Appointed Actuary's estimates from the prior analysis, with extended discussion of significant factors underlying the change. The Task Force made this recommendation to improve the transparency of disclosures in actuarial work.

The CASTF recognizes that the majority of analysis supporting an Opinion may be done with data received prior to year-end and "rolled forward" to 12/31/20xx. By reviewing the Report, the regulator should be able to clearly identify why the actuary made changes in the ultimate loss selections and how those changes were incorporated into the final estimates. A summary of final selections without supporting documentation is not sufficient.

The CASTF believes that regulators should be able to rely on the Report as an alternative to developing their own independent estimates. A well-prepared and documented Actuarial Report that is consistent with the spirit of ASOP No. 9 can provide a foundation for efficient reserve evaluation within a statutory examination. This provides benefits to the examination process and potential cost-savings to the company.

Paragraph 8: Signature

Paragraph 8 is unchanged for 2010. The CASTF requests that actuaries include a current e-mail address.

Paragraph 9: Notice regarding Errors

Paragraph 9 is unchanged for 2010.

Exhibits A and B

Exhibit B, Item 12 is changed for 2010. The 2010 Annual Statement Instructions eliminates the parenthetical reference to Schedule P Interrogatories. This has the effect of requiring Exhibit B, Item 12 to include extended loss and expense reserves for all P&C lines of business, not just Medical Professional Liability.

The reference to "Data Capture Format" from the Annual Statement Instructions merely means electronic filing. This allows for mechanical queries on demographic information and financial data. Appointed Actuaries should refer to the *Instructions* and prepare exhibits to assist the company in accurately populating the electronic submission.

Special Note on Exhibit B, Question 6: Some actuaries have commented to regulators that the wording of the question implies a probability conclusion. That is not the regulatory intention. The question intends to mirror the disclosure in the Relevant Comments regarding the Appointed Actuary's conclusion as to significant risks and uncertainties that could result in material adverse deviation. Actuaries should respond with this guidance in mind.

For those companies meeting the requirements of paragraph 1C of the *Instructions*, Exhibits A and B of the lead company should be attached as an addendum to the PDF file and/or hard copy being filed for the non-lead companies.



REGULATORY GUIDANCE
On the Property and Casualty Actuarial Opinion Summary
For the Year 2010

Prepared by the NAIC's
Casualty Actuarial and Statistical (C) Task Force

The Casualty Actuarial and Statistical (C) Task Force (CASTF) of the NAIC believes that the Actuarial Opinion Summary (Summary) is a valuable tool in serving the regulatory mission of protecting consumers. This Regulatory Guidance document supplements the NAIC's *Property and Casualty Annual Statement Instructions (Instructions)* in an effort to provide clarity and timely guidance to Appointed Actuaries regarding regulatory expectations with respect to the Summary.

Form

The Summary is intended to be a **confidential** document separate from the Statement of Actuarial Opinion (Opinion). The CASTF advises the Appointed Actuary to provide the Summary to their company separately from their Opinion. The Summary should be clearly labeled and identified prominently as a confidential document. The CASTF advises that, in order to avoid confusion, the Appointed Actuary should **not** attach the related Opinion to the Summary.

Not all states have adopted the Property and Casualty Actuarial Opinion Model Law that requires the Summary to be filed. Nevertheless, the CASTF recommends that the Appointed Actuary prepare the Summary regardless of the domiciliary state's requirements, so that the Summary will be ready for submission should a foreign state—having the appropriate confidentiality safeguards—request it. Most states provide the Annual Statement contact person with a checklist that addresses filing requirements. The CASTF advises the Appointed Actuary to work with the company in determining the logistic requirements for each state.

The Summary is **not** submitted to the NAIC.

Substance

The *Instructions* for the Summary are unchanged for year-end 2010.

Paragraphs 1–4 and 7 of the *Instructions* are unchanged for 2010 and are self-explanatory. The entire substance of the Summary rests in Paragraph 5. The required information for Parts A–D of Paragraph 5 is highlighted by the straightforward examples provided in the Summary section of the American Academy of Actuary's Property/Casualty Practice Note, *Statements of Actuarial Opinion on P&C Loss Reserves*. The content of the Summary should reflect the analysis performed by the Appointed Actuary, because the Summary is a synopsis of the conclusions drawn in the Actuarial Report.

Regulators expect that point or range estimates reported in the Summary are clearly supported and documented in the Actuarial Report. Without clarity, the documentation fails to meet Actuarial Standards of Practice and the expectation that another actuary can evaluate the work. Part E of Paragraph 5 of the *Instructions* addresses persistent adverse development. The actuary is in a unique position to be able to comment on the nature of this development. This section requires the actuary to do so. Comments can reflect common questions that regulators have, such as:

- Is development concentrated in one or two exposure segments, or is it broad across all segments?
- How does development in the carried reserve compare to the change in the actuary's estimate?
- Is development related to specific and identifiable situations that are unique to the company?
- Does the development or the reasons for development differ depending on the individual calendar or accident years?

Paragraph 6 was new for 2008. It is relevant **ONLY** in pooling situations as defined in paragraph 1C of the *Instructions* for the Opinion and provides more relevant information to the domiciliary regulator of the 0% companies.

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